An Analysis of the effect of the 1976 Financial Crisis on the Development of North Sea Oil Policy in the United Kingdom

Sophia Graeff Buhl-Nielsen, 3118

A Project carried out on the International Master's in Finance, Brazil-Europe under the supervision of: Alvaro Ferreira Silva (Nova) and co-supervised by Joao Paulo Cordeiro de Noronha Pessoa (FGV)

January 2019

An Analysis of the effect of the 1976 Financial Crisis on the Development of North Sea Oil Policy in the United Kingdom

Abstract

Traditional approaches to the study of financial crises typically involve an elucidation of causation. Meanwhile, this project seeks to take an original approach in analysing how the circumstances of a relatively minor crisis, namely that in the United Kingdom in 1976, can have long-term effects on an economy by eliciting changes in the trajectory of policy formation. Given the importance of the development of North Sea oil to contemporary international perception of Britain's ability to meet future balance of payments obligations, this project focuses on policy decisions pertaining to this domain. Through an extension of the narrative approach frequently adopted in the study of financial crises, this project finds that the crisis of 1976 had significant implications for the development of North Sea oil in two respects. It undermined the practical clout of the recently formed national oil company (BNOC), making it a vessel with political rights it was unlikely to be able to realise. Further to this, it set a precedent in terms of considering the sale of public assets as 'negative expenditure' as opposed to revenue when it agreed to the sale of £500 million in British Petroleum (BP) shares in negotiations with the International Monetary Fund (IMF) to reduce the Public Sector Borrowing Requirement (PSBR). Nonetheless, this project concludes that it was political division within and between parties that both stimulated the crisis and resulted in less than optimal policy decision-making with regards to North Sea oil.

Introduction

As the consequences of economic malaise emerge in the aftermath of a financial crisis, academics, government officials and economic agents alike engage in a retrospective diagnosis of the symptoms of a system tending toward self-destruction. The critical avenue of analysis often becomes the identification of a narrative of causation (Kindleberger and Aliber 2011, Reinhardt and Rokoff 2009, specifically for the subprime crisis Brunnermeier 2009), as well as attempting to enact a programme for recovery and reform (Baldwin and Giavazzi 2015, for the Euro-Zone crisis). In an attempt to shift the focus of inquiry, this work will focus on the consequences of financial crisis, namely how they were directly caused by the state of crisis but contributed to longer-term policy decisions that endured beyond effects typically associated with financial crises. The crisis under analysis is that in Britain in 1976, which in certain respects gave the impression of greater upheaval than the aftermath would suggest was warranted. Sterling declined over a nine-month period before agreement with the International Monetary Fund (IMF) for the largest loan issued to date assured financial markets that the budget-constrained course the British government had embarked upon was fiscally sound, as well as dissuading speculators from engaging in opportunistic action. The funding made available was never taken out in full, and repayments were made in a timely-manner. The sentiment of crisis seemed to dissipate as rapidly as it struck.

Nonetheless, decisions taken during this nine-month period had the potential to have longer-lasting implications for the British economy. By virtue of being under intense international observation, as well as subjected to scrutiny by the IMF the British government was constrained in their decision-making and forced to make choices that would present their finances in the strongest possible light. This work investigates such choices in the context of North Sea oil development. The development of North Sea oil was a highly capital-intensive activity and contributed to Britain's chronic balance of payments deficit due to the value of imports of equipment required. It was, however, also the beginning to generate revenue for the British economy, and frequently cited as the industry that would banish concerns over balance of payments by the end of the decade. This work thus analyses the extent to which the financial crisis of 1976 had a damaging impact on policy governing what was to a certain extent viewed as the very resource that would determine Britain's economic salvation. The findings are that concerns over the Public Sector Borrowing Requirement (PSBR) led to two decisions influenced by the method of accounting of this item. The first was in limiting the definition of 'participation' of the British National Oil Corporation (BNOC). Any capital expenditure or financing for a nationalised industry was included in the PSBR. Due to the high cost of development of oil fields, the British Government felt BNOC could not guarantee capital contribution to the fields it participated in, since this would result in a drastic increase in PSBR in the coming years. The precedent was thus set of BNOC as an institution with privilege and limited practical power. The second decision was that of the sale of £500 million worth of BP shares. An accident of accounting led to revenue generated by this sale being regarded as negative expenditure and constituting a reduction in the PSBR. A second precedent was set: the privatisation of state assets would be accounted for as a decrease in the borrowing requirement. Both these seemingly pragmatic decisions would have significant effects on the trajectory of the development of North Sea oil.

This paper has a rather different approach from the usual "work project format". The hermeneutic power of the narrative is here mobilized to distil the causation and explanatory process to understand the long-term effects of the 1976 financial crisis. In this sense, it escalates the explanatory power of narratives in economics, as proposed by McCloskey (1983) and Morgan (2001). The argument is unfolded as follows: Section One outlines the origins of the crisis, exploring both the long-term and immediate causes, as well as the perspective of the IMF with respect to the state of the British economy. Section Two provides an overview of the development of the North Sea up to 1976, making reference to the most significant oil fields to have been discovered. Section Three examines criticisms relating to North Sea oil policy beyond the scope of the crisis including the failure to negotiate an extended territorial boundary with Norway, mismanagement of licensing rounds and taxation policy, the neglect of the Offshore Supply industry and the lack of sovereign oil fund. These were all influenced by Britain's protracted economic issues. Section Four examines the evidence for the contribution of the crisis in North Sea oil development, as well as analysing how the fractured political landscape interacted with the condition of crisis.

1. The Origins of the Crisis

i. The slow and steady decline of a Great Power

The ailing British economy had suffered from a succession of crises in the post-war era. In part, these were warranted by the erosion of British fundamentals and the seemingly intractable economic woes that befell the nation at this time. Whilst the 'Golden Era' of 1950-1973 might have been perceived to have been one of prosperity, it was in hindsight one of relative decline. For example, although West Germany and France respectively had a GDP per person of 61.7 per cent and 71.4 per cent of that of the UK in 1950, by 1973 they had superseded the U.K in this metric by 9.3 and 6.6 per cent, respectively. This change is largely accounted for by the slower growth of labour productivity in Britain, which was 3 percentage points below that of West Germany between 1950 and 1973, and 2 percentage points below that of France (Crafts, 2017). Meanwhile, Britain had committed politically to a social programme involving high levels of public expenditure in the post-war period (Timmins, 2017). Whilst this was not unlike other European nations at the time, what was alarming was the extent to which public expenditure was coming to account for an increasing proportion of British GDP, in particular when compared to the relative expenditure of other countries.

Britain was showing signs of difficulty in meeting the programmes for social security and development it had promised the British people. For example, between 1945 and 1976, there had only been one year in which there had been a budget surplus rather than deficit (Bank of England, 1983). Net borrowing as a percentage of GDP was growing, estimated to be at 11 per cent for 1975-6 (IMF Archives, 1976). Unemployment was on the rise from approximately 2 per cent in 1950, to 5.4 per cent in 1975, with no signs that this trend would be abated in the near future (Layard and Nickell, 1986). Additionally, after only mild inflationary pressures in two decades following the war, the early years of the 1970s saw an unanticipated and inexplicable increase (Coopey and Woodward, 1996). In part, this may have been related to the oil crisis of 1973-4, whereby oil prices spiked as a result of the politically motivated embargo stimulated by the Yom Kippur war (De Gregorio, 2007). However, at a time when most countries had engaged in deflationary policies and accepted a reduction to their living standards, Britain (as well as Italy) had continued with a Keynesian outlook, seeking to spend itself out of hardship. To a certain extent, this policy corresponded with the advice imparted by the IMF, which was critically concerned with preventing the episode culminating in a global recession (Roberts, 2016). Nonetheless, instead of initiating recovery, Britain succeeded only in baffling economists by precipitating a simultaneous boom and slump, or stagflation.

By the beginning of 1974, in the wake of the oil crisis and facing industrial action by the coal miners, the emergency three-day week implemented by Prime Minister Edward Heath appeared indicative of a country on the brink of collapse. Following U-turn carried out by his government with regards to economic policy the Conservative party seemed politically discredited both in practise and principle. In February 1974, toward the end of Heath's administration, the National Institute for Economic & Social Research would observe 'It is not often that a government finds itself confronted with a possibility of a simultaneous failure to achieve all four main policy objectives: adequate economic growth, full employment, a satisfactory balance of payments, and reasonable, stable prices' (Bogdanor, 2016 p.1). National discontent had set the stage for an incoming Labour administration, albeit forming a minority government. Thus, long-term economic variables suggested there was reasonable cause for external observers to have concern over the trajectory of the British economy.

ii. Sterling crisis

Britain's vulnerability to international perception of its economic and political stability was heightened by sterling's residual status as a reserve currency. This reality made it more challenging for the Bank of England to defend sterling at a certain rate of exchange (Schnek, 1994). For decades Britain had struggled to maintain its pegged parity with the US dollar, despite significant devaluations in both 1949 and 1967. Britain had experienced numerous crises in the three decades following the end of the Second World War: 'By this time a lot of people were fed up with sterling crises' Scott Pardee of the Federal Reserve Bank of New York recollected (Burk and Cairncross, 1992 p.38). After the collapse of the Bretton Woods agreement in August 1971, Britain had adopted a pegged parity of $2.60 under the Smithsonian agreement. However, ongoing difficulties in maintaining this rate had led to Anthony Barber, Chancellor of the Exchequer at the time, to float the currency in June 1972 (Oliver and Hamilton, 2007). Whilst the continued depreciation of sterling did not necessarily constitute a currency crisis, the Bank of England still maintained a policy of intervention when the value of sterling declined at a rate they perceived to be excessively severe or not reflective of economic fundamentals.

The financial crisis of 1976 was in essence a sterling crisis characterised by prolonged and seemingly excessive decline of the currency. The first signs of distress became apparent on Thursday 4th March when sterling dropped one percent. Richard Roberts (2016) attributes this to a mishandling of a routine operation on the part of the Bank of England. The Nigerian government had requested a conversion of a proportion of their sterling balances, which was to be carried out via an exchange with the Bank of England for UK foreign currency reserves. In order to replenish reserves, the Bank of England would subsequently sell an equivalent amount of sterling to the market. By Roberts' account, the execution of this phase of the process was mismanaged and the action was perceived as deliberate intervention to make sterling more competitive. Potential buyers of sterling made themselves scarce. Hickson (2005) contributes to the narrative by assessing the decision of the Bank of England to cut interest rates the following day, questioning whether this was therefore, as markets suspected, part of a broader policy to depreciate sterling. Despite Denis Healey's account (the Chancellor of the Exchequer) distancing himself from the episode and referring to the two measures as mistakes on the part of the Bank of England, Hickson's less absolving conclusion is that Healey would have most likely have been aware of the measures, but that their intention might have been to prevent further appreciation rather than to stimulate depreciation.

Such a decline was compounded by two particularly notable political events that shook the confidence of the market in the trajectory of the British economy. On the 10th March the House of Commons rejected a White Paper, published in the afternoon of 19th February, outlining cuts in public expenditure amounting to £1.6 billion beginning in the years 1977-8. Whilst the emerging consensus within the House of Commons seemed to support the notion that such cuts were if anything overdue, a left-wing contingent of the Labour party abstained from voting due to opposition to this economic strategy, resulting in the defeat of the proposition. Burk and Cairncross (1992) note that the market would thus witness a government undermined by its own backbench when it came to the issue of public expenditure cuts. Although a vote of confidence reversed much of the damage triggered by this particular occurrence, no sooner had the dust settled than a surprise resignation by the

Labour Prime Minister, Harold Wilson, on 16th March induced alarm in the markets once more.

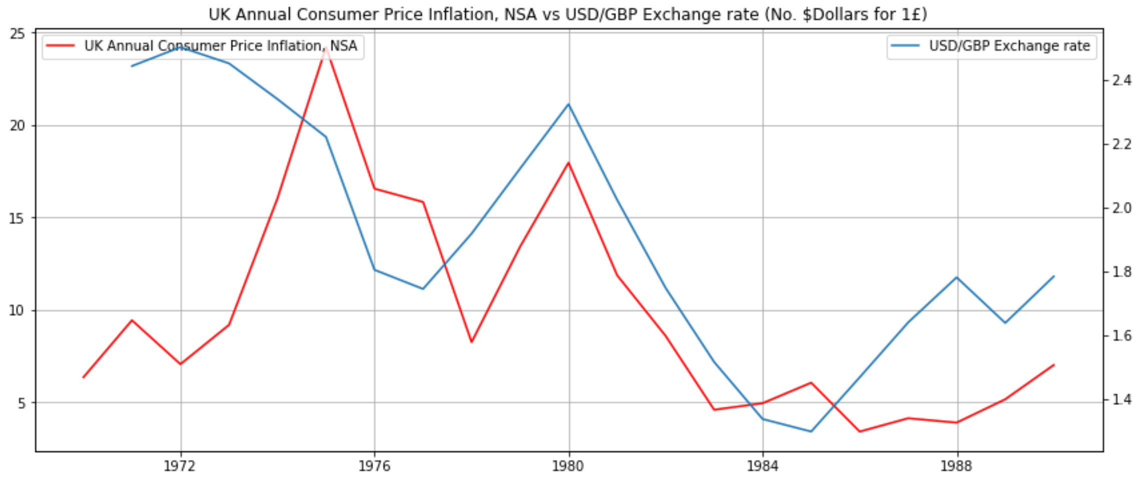

Figure 1: Historic inflation and USD/GBP Exchange rate, Source: IMF

Despite being typically recognised as the beginning of the 1976 crisis, marking the onset of the depreciation in sterling that was to progress over the coming months, application to the International Monetary Fund (IMF) for a loan would not be announced until 29th September. In the interim, Britain had successfully secured $5.3 billion in credit from the Group of Ten, comprised of Western democratised nations that agreed to facilitate the IMF's lending from 1962 onwards, on the condition that if they could not repay their withdrawing from this provision by the 7th December of that year, they would have to negotiate with the IMF for further funds (Roberts, 2016). Official documents indicate that for weeks prior to the announcement the government had recognised this as highly probable and were contemplating the optimal approach to the organisation: 'The $5.3 billion standby credit which we secured at the beginning of June has barely given us breathing space' began an account of the economic situation published in the cabinet papers from 13th July 1976. However, it would appear that it was the sudden drop in the value of sterling on 28th September, that would underscore the urgency of taking these steps. It was this news that notoriously prompted Healey's volte-face from Heathrow airport; an image that would remain ingrained on popular imagination as reflecting the desperate and fragile state of the national economy (Roberts, 2016).

iii. The position of the IMF

What was perhaps most remarkable about the crisis was the extent to which it seemed short-lived and superficial. After announcing the approval of the IMF for standby credit in December, sterling rapidly recovered and remained stable through-out 1977. Confidential documents in the IMF archive reveal that already in July 1976 members of the Executive Board had a nuanced appreciation of the reality of the British economy and could discern that the markets were responding in an overly pessimistic manner. For example, Mr Ryrie, UK Executive Director of the IMF, emphasised that 'the Public Sector Borrowing Requirement in the United Kingdom was a wider concept than is in use in most countries and cannot be directly compared with concepts of surplus or deficit elsewhere' (IMF Archives,1976 76/116). Furthermore, not only did he note that the government had already committed to public expenditure cuts but that they had introduced cash limits as a technique for controlling it. 'The new measures will clearly mean there will be a fall in public expenditure in real terms in 1977/78' (IMF Archives,1976 76/116) he concluded. In fact, the IMF had raised their forecast for GDP growth for 1976 in the midst of the crisis. Mr. Whitelaw, Australian Executive to the IMF, 'was pleased… that the economy was on the road to recovery; the rate of inflations had fallen, the current account position had improved, and the level of exports seemed to be increasing' (IMF Archives,1976 76/116). Several mentions of the imminent ramping up of North Sea oil production were made yet concerns over both the Public Sector Borrowing Requirement and the poor performance of nationalised industries such as the British Steel Corporation were also raised. Neither of these boded well for the fledgling national oil corporation, BNOC, and the political hope of establishing greater public control over North Sea Assets.

2. The Discovery and Development of North Sea Oil

Accounts of the North Sea Oil seldom fail to make reference to Prime Minister James Callaghan's assertion in 1977 that 'God has given Britain her best opportunity for one hundred years in the shape of North Sea oil' (Shepherd, 2015). Similarly, in the wake of the issuing of Britain's largest IMF loan to date, the headline of the Financial Times optimistically directed the future of British finance 'From the IMF to the North Sea' (Lex: Financial Times, 1977). This confidence in recovery due to the development of North Sea oil might have seemed out of place with the progress thus far made toward the recovery of the resource. It had been discussed within Parliament that the expected royalties from oil for the year ending 31st March 1976 stood at only £0.3 million (Hansard Historic, 1976a).

Whilst the onshore production of oil had been an earlier development in the United Kingdom, exploration of the North Sea began only after significant Dutch discoveries, including that of the Groningen field in 1959, which remains one of the largest gas fields in the world (Breunese, 2005). The discovery of this field was reported in trade journals following its mention in a European Parliamentary debate on energy policy in 1960 (Shepherd, 2015). Governments of countries bordering the North Sea started to be approached by major international oil companies for permission to begin exploration in their waters (Cabinet Papers, 1964). Within five years, the Government of the United Kingdom had ratified an agreement with all boarding states, most significantly including Norway, regarding maritime boundaries and it had under taken its first licensing round with generous offerings of offshore blocks to oil companies and itself. Drilling in the North Sea had commenced in 1964, and by September of the following year British Petroleum (BP) announced the discovery of the West Sole gas field off the coast of Yorkshire (National Archives, 1970).

By 1967 exploration of the North Sea began to move more centrally. Two years later Montrose, the first oil field in offshore British waters, was discovered by Amoco offshore from Aberdeen (Shepherd, 2015). Shell had also made an oil discovery that year, on one of the Gannet fields, but their drilling had only penetrated the edge of the field and they were subsequently decidedly underwhelmed by their findings. Shortly following this, in October 1970, BP discovered the largest oil field in the North Sea, the Forties field. This field came on-stream in September 1975, soon after the first oil production from the North Sea had commenced from the Argyll field, and by the turn of the century had produced over 2.5 billion barrels of oil (Bamberg, 2000). The profits from the production of the Forties field were so great by the late 1970s, that one manager was to claim that at the tax levels then imposed BP would be able to buy most, if not all, of the declining British manufacturing industry (Shepherd, 2015). This was a particularly dramatic reversal in the stand point of the company, which had informed the Reuters news agency six months prior to the discovery, of scepticism over whether there was to be any oil found in their licensed blocks (BP, 2018).

Exploration and drilling in the North Sea was an expensive venture, at a cost ten to twenty times greater than that of onshore operations (Shepherd, 2015). The decision to begin drilling in the North Sea had been made economically viable by the hike in fuel prices following the combined assault of conflict in the Middle East and domestic industrial action on the part of the coal miners (Noreng, 1980). The North Sea was at the time the region of earth with the harshest weather in which oil drilling would be attempted and special precautions had to be taken. For example, when platforms were brought into operation oil had to be collected by tankers from a radius of at least a mile away to prevent collision due to rough seas (BFI Database, 1977). Technology involved in the drilling of offshore oil had largely been developed in explorations of the Gulf of Mexico and would have to be adapted for use in the North Sea (Beckett, 2009). Decades later, Basil Butler of BP was to attest that it had been desperation to diversify away from the Middle East that had brought oil companies to the North Sea (Shepherd, 2015). Against the backdrop of British decolonisation and decline in overseas military presence, as well as the rise in Arab nationalism and the perception of oil as a resource belonging to the state and its peoples, many oil companies rightly feared that their assets in these regions would be nationalised (Yergin, 1990). Whilst the development of North Sea oil might have seemed an economically attractive option to the British government and consumer, the move to this region might have principally been a hedge against political risk for most oil companies. Indeed, BP officials had gaped at the forecast that the Forties field would cost £370 million to develop. Little did they know at the time that the final bill would be multiples of this figure (Shepherd, 2015).

In summary, a significant degree of uncertainty surrounded the North Sea in terms of the quantity of reserves, meaning that oil companies accepted considerable risk when they engaged in exploration and development of the region. The costs of development were unparalleled due to the particularly harsh climatic conditions and the depth of the oil reserves. However, due to the political uncertainty in regions with conditions more favourable to development, as well as the vast quantities of oil that ultimately were discovered, portfolio diversification into this region ultimately proved highly lucrative for companies able to generate sufficient capital to invest there. The next section will highlight the ways in which the government failed to optimise their policy with respect to the North Sea over a protracted period due to ongoing economic concerns.

3. A Sea of Lost Opportunity[42]

i.The hasty division of the Continental Shelf (1964)

Mismanagement of the develpment of North Sea oil arguably began before exploration was underway in earnest. John Liverman, who had been Deputy Secretary at the Department of Secretary and responsible for the North Sea oil and gas policy when Margaret Thatcher became Prime Minister in 1979, recalled some two decades later how she accusatorily asked him why he had let the Norwegians get away with it (Institute of Contemporary British History, 1999). The Prime Minister was referring to the agreement between Britain and Norway as to where the North Sea should be divided with respect to national sovereignty over the extraction and ownership of subsea resources, namely oil and gas. The maritime divide agreed with the Norwegians as part of the Continental Shelf Act (1965) was a median line between the two countries. What would be repeatedly highlighted following this decision was that the existing maritime laws were sufficiently open to interpretation as to have provided scope for British negotiation to extend their territory. Indeed, what both contemporary and current accounts suggest is that due to the definition of Continental Shelf that was used at the time, as well as the existence of a deep trench approximately 50 miles from the Norwegian coastline, it would have been possible to make a case for a lack of Norwegian claim to any part of the subsea resources within the North Sea.

This avenue for extending the British domain of the North Sea was by no means an argument that had slipped the attention of those involved in the composition of the legislation. During discussions of the Continental Shelf Bill in the House of Lords on 3rd December 1964, Lord Shackleton, geographer and son of the famous British explorer Ernst Shackleton, remarked: '…the continental shelf comes to an abrupt end about 50 miles, or a little more, off the coast

---

[42] In reference to the work by Norman J. Smith, *The Sea of Lost Opportunity: North Sea Oil and Gas, British Industry and the Offshore Supplies Office*

of Norway, and there is then a great deep. I should have thought that the British area extended right up to that deep, and that Norway, which none the less seems to have signed the Convention, would virtually have no continental shelf at all.'(Hansard Historic, 1964). Two weeks later, by 17th December, Lord Shackleton had changed his position, admitting he had been wrong in his previous interpretation. Following one further brief mention in the House of Commons on 28th January 1965, the issue seemed to be dropped entirely (Hansard Historic, 1965).

The decision on the part of the British to so easily relinquish any further claims to the North Sea was met with surprise by external contemporary observers, as well as being a cause of disquiet amongst domestic politicians. For example, a U.S. intelligence report, published on 14th June 1974 remarked that 'The distinguishing feature of the agreement between Norway and the United Kingdom is that the deep Norwegian Trench was ignored in the determination of the CSB. If the coastal 100-fathom contour had been used in delimiting the Norwegian claim to the continental shelf, their claim would have been virtually non-existent…' (The Geographer, 1974 p.5). Meanwhile, it has retrospectively been explained both as a tactical manoeuvre by the British government to avoid negotiations that could delay the extraction of oil from the region, as well as a means of appeasing the Norwegians (Shepherd, 2015). Nonetheless, James Allcock, former senior executive of the British Gas Corporation, claimed that the Norwegians themselves were astonished by the concession. Whilst the exact unfolding of the decision to bypass further negotiations remains to be fully detailed, it would seem likely that it was concern amongst those in the cabinet not to delay development of a valuable resource that fast-tracked the process. Indeed, there was a degree of alarm in the House of Lords in December 1964 due to the bill in question not following the regular procedures, seemingly allowing less time for readings and discussion of the terms than customary (Hansard Historic, 1964). It would appear that the British administration had determined that such a delay as negotiations would entail was not one the economy could afford.

ii. The mistakes of administration: licensing and tax revenues (1964-1975)

Beyond the negotiations and diplomacy involved in securing an agreement with a fellow sovereign nation, the British are believed to have mismanaged North Sea resources in their unpreparedness for dealings with multinational oil firms. With respect to this domain the criticisms are twofold. The first realm of discontent concerns the licensing terms for exploration in the North Sea. Up until the financial crisis in 1976 there had been four licensing rounds. The first had been in 1964, followed by the second in 1965. After a few years the third followed in 1970 and a fourth in 1971/2 (Oil and Gas Authority, 2018). A key figure in these licensing rounds was Angus Beckett, the undersecretary of the Petroleum Division of the Ministry of Power. He became the focal point of reproach from Liberals and leftists who claimed that the government had granted over-lenient terms to major oil companies, including the licensing term of up to 46 years. In a review of the process in 1972, the House Committee of Public Accounts had likened Britain to a 'gullible sheikdom'. National interests were thought to have been pushed aside by the sharper-pointed capitalist elbows of multinational companies. British national industries had gained a mere twelve per cent of concessions, whilst inclusion of private national firms increased this figure to thirty per cent. 'All the producing oil fields in the North Sea were licensed by Angus', recalled Richard Funkhouser, an American diplomat and geologist who had known him. In response to the casting of blame for the betrayal of national interest he further remarked 'a monument should and would be erected to him for saving Britain from the disaster that would have hit, without the oil lifeline which he personally produced when at the Department of Energy' (Harvie, 1994 p. 85). Such a comment served not only to underscore Beckett's centrality to proceedings, but also emphasise the extent to which the haste to begin development of the

North Sea might have led to oversight in introducing more measured licensing arrangements for the first four rounds.

Beyond this, the second domain of criticism was the degree to which the government failed to adequately tax profits made by these firms from North Sea oil. Such firms seemed to systematically underestimate the reserves of the North Sea, whilst simultaneously emphasising the singular challenge of climatic conditions so as to make it appear that they were doing the British people a favour by agreeing to explore the region. Once the extent of potential profits became apparent following the discovery of oilfields such as the Forties, public outrage commenced over the leniency of taxation on these firms. ‘Between 1965 and 1973 the oil majors’ corporation taxation liability in the UK was £500,000,’ reported the Public Accounts Committee in 1972. ‘It is hard to believe that the profits made did not warrant a higher tax payment,’ it continued, echoing popular sentiment (Public Accounts, 1973 p.12).

iii. Failure to develop the Offshore Supply industry (1958-73)

No less was the government criticised for its ineptitude in administering North Sea oil such as to maximise tax revenues than it was lambasted for not sufficiently investing in the development of an offshore supply industry. The lethargy with which the British government responded to the realisation that oil extraction would require a corollary industry to support the process through the provision of supplies such as rigs, platforms and vessels has been minutely chronicled by those such as Norman J. Smith (2011). His account highlights how the government were delayed in introducing policies that would help direct orders for offshore supplies toward British industry. For example, the Offshores Supplies Office was established only in 1973 with the aim of encouraging upwards of 70 per cent of such orders to be placed with national firms. Two years later, when the Department of Energy first published statistics on this industry it was evident that this figure was far below this at approximately 52 per cent.

The majority of offshore supplies were thus not constructed in British dock yards, but imported, principally from the Americans and the Dutch. Commentators point out that despite having no experience with the oil industry, or reserves to itself exploit, France was much more agile in responding to the forecast needs of exploration and production companies (Smith, 2011). Meanwhile the British, despite a legacy of close affiliation with two major oil companies, let pass by an opportunity of exceptional magnitude for their industrial sector. Furthermore, importing offshore supplies had a significant impact on the balance of payments. Indeed, capital expenditure on North Sea oil development peaked in 1976, the year of the financial crisis, which accounted for 80 per cent of United Kingdom Continental Shelf (UKCS) expenditure (Harvie, 1994). This amounted to £1.2 billion worth of imports, at a time that could scarcely be more burdensome.

iv. The absence of an oil fund (1974-2018)

The legacy of an opportunity missed might sit more comfortably with British collective memory had the revenue of oil production been seen to be spent more astutely. It has been observed that by the 1980s the government was no longer plagued with concerns over the balance of payments due to the impact of oil revenues, an observation cynically followed by the analysis that this money was being squandered on increased imports and unemployment benefits. The mismanagement of North Sea oil revenue became a point of contention in particular due to claims by the Scottish National Party that the oil of the North Sea was a national asset of the Scottish people and provided an economic basis for their claim to independence. The party itself seemed to adopt this line of argument relatively late in the development of the North Sea, whilst by 1977 one survey found that only 13 per cent of the party's supporters were aware of this policy. Nonetheless, it was a point which came to be avidly debated in Westminster as the English were loath to relinquish control of these assets, and thus were compelled to find ways in which to contain the campaign for devolution such that it did not infringe on their prerogative of oil extraction (Beckett, 2009). That the government determined not to make an oil fund was a point continuously resurrected both by ongoing political movements seeking Scottish independence, and by comparisons with the Norwegians, who having invested their North Sea oil revenues now boast one of the largest sovereign wealth fund in the world (Kern, 2007). Ahead of the referendum on Scottish independence in 2014 attention was once more drawn to the lack of an oil fund and the fact that revenues had not been spent on investing in local areas involved in the oil industry, such as Aberdeen, but had by and large been appropriated by London (The Scottish Government, 2013). Meanwhile, in 2018 the Institute for Public Policy Research concluded that had the UK developed a sovereign wealth fund in tandem with authorities in Oslo, it would now be worth around £500 billion (Robert's and Lawrence, 2018). Larry Elliott (2017) commented '…creating a sovereign wealth fund would involve deferred gratification. That's not how we do things in Britain', encapsulating lack of control over the British appetite for near-term spending in preference to long-term investment. To add insult to injury, Scottish Nationals are unlikely to let rest the belief that the money Westminster frittered away had not been theirs to spend in the first place.

Throughout the development of North Sea oil, oversights were made by successive governments, in part associated with concern for the British economic condition. North Sea oil was developed with a considerable degree of haste, as exhibited by the failure of the Government to negotiate with Norway for further territory and significant secession of acreage during the first four licensing rounds. There was a limited degree of planning in policy-making but rather it seemed to develop on an ad-hoc basis as errors became evident. In part, this may have related to the nature of the asset: given uncertainty over the quantity of reserves it was difficult to assess their value or implications for the economy. Nonetheless, it can be said with a degree of confidence that these would have been greater had policy-makers been more cautious and conscientious.

4. Control and Co-operation in the North Sea

i.The fifth licensing round and BNOC

The Labour administration had important decisions to make regarding one of their largest domains of investment in 1976: the development of North Sea oil. The fifth offshore licensing round, and the first to take place under a Labour government, was scheduled for the end of the year. The Left had ardently criticised the form of the previous four rounds, whereby they alleged that the North Sea had haplessly been portioned out under the clumsy vigilance of the Tories (Harvie, 1994). Thus, they were adamant that they would run a more measured and sustainable process. The determination to do so had to be balanced against some of the more grandiose promises made in Wilson's General Election Manifesto (1974). Given the impact of the oil crisis in the country, it was felt at the time that the British public would show a preference for greater state control over North Sea oil. The manifesto thus proposed the establishment of the British National Oil Company (BNOC), which would defend the national interest through measures such as majority participation in every new licence in the North Sea, and negotiations on all formerly issued licences. The critical decision to be negotiated at the time of the financial crisis was the definition of what majority participation would constitute in the licensing round they claimed would shape the ongoing credibility of the British government in North Sea oil development.

In terms of proportion, BNOC would make claim to the minimum percentage necessary to establish majority participation, namely 51%. However, the British government had uniquely decided that this would mean that BNOC would fund an equitable contribution to partners in licensed blocks in terms of exploration and development (Hansard Historic, 1976b). The issue most keenly debated within Cabinet in this regard in the Summer of 1976 was whether this commitment would be financed as these processes were underway, or whether the payments would be deferred until they could be compensated from revenues (Cabinet Papers, 1976). Secretary of State for Energy, Tony Benn, proposed that financial commitment from the outset was needed to ensure that the fifth licensing round was attractive to investors and thus a success. He believed that 'If the Corporation refused to put in its share of the costs, it would become simply a sleeping partner, and its credibility as a State oil company would be destroyed. By taking a financial stake on the other hand, it would get all the information it needed and in addition would be able to influence the placing of orders with the supplying industry,' as recorded in the Cabinet Papers from 5th May 1976. The argument put forth for contemporaneous investment was that initial exploration costs were forecasted as being low, amounting to £12 million between 1976-1979. Even if BNOC did not contribute, much of this cost would be refunded by the government to private enterprises due to tax conditions that had been crafted to encourage investment in the area.

This financial argument was countered by the Treasury in two respects. First was that such a comparatively small investment would therefore not give much status to the firm in any case. Secondly, that the negotiation of participation by BNOC in pre-existing licenses in the absence of financial contribution had not prevented the agreement of satisfactory terms for the Corporation. However, the critical issue was not so much exploration costs as development costs, which would dwarf the former by comparison. Furthermore, the concern of the Cabinet was that funding for BNOC would be accounted for in the Public Sector Borrowing Requirement, which was currently under intense scrutiny due to negotiations with the IMF for standby credit. In the same cabinet paper, the Chief Secretary of the Treasury 'agreed it was unfortunate that borrowing abroad by BNOC scored as part of the public sector borrowing requirement, but it would be impossible to change the existing conventions until the country's financial position as a whole was stronger. If the Government gave the impression at the present it would be ready to contribute their share of the huge costs which would eventually arise on development, as they arose, the knowledge of these potential obligations would create very serious problems for Britain's credit abroad.' In other words, due to the observance of British public expenditure, particularly the borrowing requirement, it was possible neither to alter the accounting methodology such that BNOC's capital expenditure was not recorded under this classification, nor was it possible to make substantial commitments to future spending without causing alarm and possible further devaluation of sterling. The compromise reached by the Cabinet was that BNOC would broadly engage in exploration costs and consider participation in development finance on a case by case basis. What this constituted was a significant betrayal of the principles set out in the Labour manifesto of 1974 and the foundation of the pathway toward the political Right in the management of North Sea oil.

ii. Sale of BP Shares

A second accident of accounting with significant repercussions for the future management of Britain's North Sea oil management was how the sale of British Petroleum stock was recorded in National Accounts. In the final agreement reached with the IMF for the loan in December 1976, the British government had outlined public expenditure cuts of £1 billion and further proposed the sale of £500 million in their holding of shares in BP, amounting to 17% of the company, as described in the Cabinet Papers from 13th December 1976. By 1976, the State had come to hold 68% of BP. This had been both the result of their historic interest in the company, and events that transpired in the wake of the oil crisis. Burmah Oil Ltd., a Scottish enterprise holding a 20.5% interest in BP had reached near bankruptcy as a result of declines in profit and a slump in BP stock price, which had served as collateral against multiple loans it had taken out. Since BP's stock price had in part fallen due to their commitments in the North Sea and Alaska, as well as general lows in the British stock market, the Bank of England had stepped in to guarantee £300 million of Burmah's loans, to prevent a loss of confidence in the North Sea oil project. In doing so it had gained control over Burmah's stake in BP (Harvie, 1994). As described in the Cabinet Papers from 7th December 1976, the government had thus planned to retain a 51% holding in BP and sell the additional 17% it had gained from Burmah. Although there had been a number of scandals implicating BP over the course of the year, drawing renewed attention to the government's relationship with the firm, the decisive issue was that the sale would qualify as negative public expenditure, and therefore go some way toward compromising with the IMF on the issue of higher expenditure cuts. In truth, the sale of BP stock was a one-time measure, with no significant consequence for the trajectory of the British public expenditure in the long-term. However, acceptance by the IMF legitimised the presentation of the sale of public assets as negative expenditure (Feigenbaum, 1998).

After the announcement of the agreement with the IMF over the terms for the loan, the value of sterling recovered, and remained relatively stable for the course of 1977. It was almost as though the market had forgotten the issue of the sale of BP stock, which eventually took place in July 1977 (New York Times Archives, 1977). Although seemingly unnecessary at that point, the government were concerned that they should not appear to be reneging on the terms set out in their agreement with the IMF, for fear of disturbing market confidence in the fulfilment of their more substantive concessions, as outlined in the Cabinet Papers from 11th March 1977. In this document it was further observed, that since the government holding was accidentally, rather than strategically, at 68%, the sale of 17% of the stock would be a relatively painless way to meet targets for 1977-8 expenditure cuts. Although it was briefly suggested that the shares could be kept in the public domain via the establishment of a State-owned holding company, this option was discarded as soon as it was noted 'the money raised by any company in the public sector would count as part of the financing of the Public Sector Borrowing Requirement; it would not reduce it.' The government were thus cornered into the first significant privatisation in the British oil industry, which would escalate in the next seven years to include the full privatisation of BNOC's operations. Unwittingly, the Labour administration had taken decisions that would set precedents for future Thatcherite policies, which represented the antithesis of their fundamental beliefs. The financial crisis, and the observance of the international community of their public expenditure had forced decisions that from a superficial perspective might have seemed relatively inconsequential, yet contextually represent the swinging of the pendulum from the ideals of one extreme, to the reality of another.

Whilst the financial crisis and the necessity of complying with external expectations thus had an effect on long-term domestic policy with respect to North Sea oil development, an analysis of the policy developments in the North Sea reveals a more fundamental issue. Although the financial crisis meant that in the short-term the British government were constrained in their decision-making, arguably both the financial crisis and subsequent policy judgements were the result of political fracture and disruption. This fracture made itself evident on multiple plains. However, two will be highlighted for the purposes of illustrating the tensions caused in orchestrating North Sea oil development.

iii. Tony Benn, contrarian and Secretary of State for Energy

The first was that between the Labour party itself, which following its defeat in 1979 would dissolve into a leadership contest. In 1981 the Secretary of State for Energy, Tony Benn, led an unsuccessful campaign against incumbent Deputy Leader, Denis Healey, formerly Chancellor of the Exchequer (Healey, 2015). Tony Benn represented the far Left in the Labour party, and others within the party had previously sought to restrain his political progress and influence (Pimlott, 2016). His appointment to the Department of Energy had in fact constituted a demotion, hoped to contain his more radical sentiments. During the financial crisis in 1976 he had championed the ‘alternative strategy’ of protectionist import duties, which were rebuffed by the centrist core in favour negotiating a loan with the IMF (Wickham-Jones, 1996). His seemingly outlandish suggestions at the time of the crisis caused difficulty in ability to convince others of his more far-sighted measures in the domain of energy policy. Whilst he was successful in drastically reducing the number of blocks offered by the government in the fifth and sixth offshore licensing round his influence was short-lived (Oil and Gas Authority, 2018). His policy in preference of controlled depletion via the cautious licensing of smaller portions of the North Sea paralleled the strategy adopted by the Norwegians (Harvie,1994). Nonetheless, he proved unable to introduce sustained change in policy. Furthermore, despite begrudgingly accepting the sale of BP assets, he once more demonstrated his percipient judgement when writing: ‘We have handed some of the most valuable assets of this country to the Shah to the Americans and to private shareholders, and I am ashamed to be a member of the Cabinet that has done this...We have provided a blueprint for selling off public assets in the future and we will have no argument against it. It is an outrage …’(Benn, 2017 p.112). Lamentably, this was a private rather than public reflection.

Perhaps the policy he supported that was most regrettably not carried through was that of the creation of an oil fund. Although in 1974 all parties seemed to support the notion of the development of a North Sea oil fund, when discussions were held amongst the Cabinet in February 1978 after two years of debate, Tony Benn seemed in isolation to defend the idea of a separate fund for North Sea oil revenue as illustrated by the Cabinet record from 16th February 1978. By a large majority in the Cabinet it was decided there should be no separate fund created. The proceeds of the North Sea oil were to be spent on increased general public expenditure and tax cuts.

iv. Discontent of the Scottish Nationals

In this Cabinet paper from 16th February 1978 it was further observed that the idea of creating an oil fund 'would [have] be particularly welcome to Scottish opinion. Other political parties had virtually committed themselves to the establishment of a special Scottish oil fund.' Throughout 1976, Parliament simultaneously engaged in debates over the devolution of power to Scotland, to establish limited independent legislative authority in the nation, as well as entirely disregarding any claim made by Scotland to having national sovereignty over North Sea assets, which fell within what would have been classified as their territorial waters. 'The boundary drawn for the purpose of defining the Scottish and English jurisdiction areas on the Continental Shelf is not relevant to the attribution of reserves,' was typical of the reply from Westminster to the suggestion that Scotland might have any sort of independent claim to the oil reserves adjacent to their border (Hansard Historic, 1976c). The notion of a boundary was unthinkable to Parliament given that the majority of reserves would have then had to be relinquished to Scotland, and recovery of the financial situation depended in no small part on the perception that the government would shortly have access to significant revenue increases from North Sea oil production. However, suffocation of Scottish national interests ultimately proved to be the downfall of the Callaghan government. As a minority in Parliament, Labour relied on the support they received from the Scottish National Party, which was rapidly withdrawn in 1979 after the referendum on the devolution of powers was unsuccessful. Although 51.6% voted in favour of devolution, only 64% of the electorate voted, in this way falling to meet the effective support threshold of 40% of the population needed to pass the resolution (Harvie, 1994). The Scottish once again felt they had been cheated by London. The tragedy was that recognition of Scottish interests with respect to the North Sea oil might have resulted in both more astute management of revenues and prevented the demise of the last Labour administration for almost two decades.

As opposed to the effect of protracted economic turbulence in leading to leniency and oversight in policy governing North Sea oil development, the condition of the financial crisis reduced activity and prompted a minute oversight of the assets and financing of the region. Manipulations to the trajectory of North Sea oil were made, which at first were merely marks on a balance sheet: The Cabinet scratched out BNOC capital expenditure development costs and £500 million in BP shares to appease the IMF and financial markets who were less interested in the details than they were in a palatable PSBR figure. Nonetheless, these decisions would ultimately contribute to the rapid retreat of the state from the vision of public participation and control over the North Sea.

Conclusion

The argument that Britain mismanaged its North Sea oil resources is not by any means mainstream, in part because consideration of the development of the North Sea from a macroeconomic perspective has not been the focus of extensive research inquiry. This work has sought to synthesise the arguments that do exist from disparate sources to show how protracted problems with the post-war economy influenced the lack of negotiation over the extent of the continental shelf, the naïve nature of early licensing rounds, the failure of the British government to adequately tax multinational enterprises, and the opportunities missed in the offshore service industry and establishment of an oil fund. The key revelation as to the investigation over how the financial crisis affected the development of North Sea oil was how international attention to the process of public expenditure accounting led to two seemingly harmless policy decisions, which came to have significant repercussions in the long-term. This included the inability to commit the national oil company to the development costs of licensed blocks it would supposedly have a majority participation in, undermining it from the outset. It further set a precedent in terms of how the privatisation of oil assets could qualify as negative public expenditure, which ultimately became the intended fate of national oil company as soon as the Thatcher administration came to office. However, it would appear that the broader theme contributing to both the origins of the financial crisis and the mismanagement of North Sea oil was the issue of political division. This turmoil caused a pervasive sense of uncertainty and elicited a crisis of confidence as to the direction of British economic development and political leanings. This was fundamentally at the core of the financial crisis, and the decisions taken by Labour that distanced it from its traditional stance. In many ways the oil crisis of 1973-4 opened up a brief window of opportunity whereby popular desire for public control over and cautious management of North Sea oil resources was particularly acute. However, this window was shattered by the internal fissures between those governing at the time. By the time these had been repaired and reformed, it was too late to restore their vision for North Sea oil.

Primary Source Documents and Resources:

Bank of England. 1983. Funding the public sector borrowing requirement: 1952-83

Beneath the North Sea (1977)- Oil Exploration in the North Sea- UK Industrial Film, BFI database

Cabinet Papers: 10th September 1964, 13th May 1976, 13th July 1976, 30th November 1976, 7th December 1976, 13th December 1976, 11th March 1977, 16th February 1978

Continental Shelf Act (1964) Chapter 29

Elliott, Larry. 2017. *Norway's $885bn-nil Advantage in Britain's Sea of Social Troubles.* London: The Guardian

February 1974 Labour Party Manifesto accessed via: http://www.labour-party.org.uk/manifestos/1974/feb/1974-feb-labour-manifesto.shtml

Historic Hansard, 1964: House of Lords Debate 17th December 1964

Historic Hansard, 1965: House of Commons Debate 28th January 1965

Historic Hansard, 1976a: House of Commons Debate 4th March 1976

Hansard Historic, 1976b: Written Answers, 19th July 1976

Hansard Historic, 1976c: House of Commons Debate, 7th December 1976

Institute of Contemporary British History, seminar, 11 December 1999

International Monetary Fund. 1976. Meetings of Executive Board Minutes 76/116

Lex: Financial Times, January 5th 1977

National Archives: West Sole gas field: production of gas by British Petroleum in the southern sector of the North Sea, January 1970

New York Times Archives. 1977. British Government Block of 67 Million B.P Shares Prices at Over $1 Billion

North Sea oil and gas: First report from the Committee of Public Accounts, H.M.S.O (1973)

The Geographer, Bureau of Intelligence and Research of the Department of State. 1974. *International Boundary Study Series A: Limits in the Seas, North Sea Continental Boundaries*. Washington DC: Department of State

The Scottish Government. 2013. *Scotland's Future: Your Guide to an Independent Scotland.* Edinburgh: The Scottish Government

Books and Journal Articles:

Bamberg, James. 2000. *British Petroleum and Global Oil 1950-1975.* Cambridge: Cambridge University Press

Beckett, Andy. 2009. Wh*en the Lights Went Out: Britain in the Seventies*. London: Faber and Faber

Bogdanor, V. 2016. *The IMF Crisis, 1976*. Gresham Lecture. Transcript accessible at: https://www.gresham.ac.uk/lectures-and-events/the-imf-crisis-1976

Breunese, J., Mijnieff, H. & Lutgert, J. 2005. 'The life cycle of the Netherlands' natural gas exploration: 40 years after Groningen, where are we now?' *Petroleum Geology*: North-West Europe and Global Perspectives- Proceedings of the 6th Petroleum Geology Conference, 69-75.

Burk, K., & Cairncross, A. 1992. *Good-bye, Great Britain: the 1976 IMF crisis*. Location: Yale University Press.

Coopey, R., & Woodward, N. W. C. (Eds.). 1996. *Britain in the 1970s: The troubled economy*. UCL Press.

Crafts, N. 2017. *The Postwar British Productivity Failure*. Warwick: Warwick Working Series Paper

De Gregorio, J., Landerretche, O., Neilson, C., Broda, C., & Rigobon, R. 2007. 'Another pass-through bites the dust? Oil prices and inflation [with comments]'. *Economia*, *7*(2), 155-208.

Feigenbaum, H., Henig, J., & Hamnett, C. 1998. 'The United Kingdom: From pragmatic to systemic privatization'. In *Shrinking the State: The Political Underpinnings of Privatization*. Cambridge: Cambridge University Press.

Harvie, C. 1994. *Fool's gold: the story of North Sea oil*. Hamish Hamilton.

Healey, Denis.2015. *The Time of My Life.* London: Meuthen Publishing

Hickson, K. 2005. *The IMF crisis of 1976 and British politics* (Vol. 3). IB Tauris.

Kern, S .2007. Sovereign wealth funds–state investments on the rise. *Deutsche Bank Research*, *10*, 1-20.

Kindleberger, Charles P. and Robert Z. Aliber (2011). *Manias, Panics, and Crashes: A History of Financial Crises*. New York: Palgrave-Macmillan

Layard, R., & Nickell, S. 1986. 'Unemployment in Britain'. *Economica*. *53*(210), S121-S169

Markus K. Brunnermeier (2009), "Deciphering the Liquidity and Credit Crunch 2007–2008", *Journal of Economic Perspectives*, 23(1): 77-100.

Noreng, Oystein.1980. *The Oil Industry and Government Strategy in the North Sea*. New York: Routledge

Oliver, M. J., & Hamilton, A. 2007. 'Downhill from devaluation: The battle for sterling, 1968–72 '1. *The Economic History Review*, *60*(3), 486-512.

Pimlott, Ben. 2016. *Harold Wilson*. New York: Harper Collins

Reinhardt, Carmen and Kenneth S. Rogoff (2009). *This Time Is Different. Eight Centuries of Financial Folly*. Princeton (NJ): Princeton University Press.

Richard Baldwin, Francesco Giavazzi (eds.) (2015), *The Eurozone Crisis: A Consensus View of the Causes and a Few Possible Solutions*. London: CEPR Press.

Roberts C and Lawrence M.2018. 'Our Common Wealth: A Citizens' Wealth Fund for the UK', *IPPR (*working paper)

Roberts, Richard. 2016. *When Britain Went Bust*. London: OMFIF Press

Schenk, C. R. 1994. *Britain and the Sterling Area: from Devaluation to Convertibility in the 1950s*. Routledge.

Shepherd, Mike. 2015. *Oil Strike in the North Sea*. Edinburgh: Luath Press

Smith, Norman. 2011. *The Sea of Lost Opportunity: North Sea Oil and Gas, British Industry and the Offshore Supplies Office*. Oxford: Elsevier

Timmins, N., (2017), *Five Giants: A Biography of the Welfare State*, London: Harper Collins

Wickham-Jones M.1996. 'Labour's Alternative Economic Strategy'. In*: Economic Strategy and the Labour Party*. London: Palgrave Macmillan

Yergin, Daniel. 1990. *The Prize; The Epic Quest for Oil, Money and Power*. New York: Simon & Schuster